The New Federal Insurance Office

by Eric C. Nordman, CPCU, CIE

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Overview

The purpose of this article is to explore details of the new Federal Insurance Office (FIO).

The Dodd-Frank Wall Street Reform and Consumer Protection Act established the FIO in Title V. The FIO is housed in the Department of the Treasury and is headed by a director who is appointed by the secretary of the Treasury. This article will explore both what the FIO is authorized to do, as well as areas in which it has no authority. In general, the FIO is an adviser to the secretary of the Treasury and a source of information to other areas of the federal government.

Scope And Functions

The FIO is authorized to cover all lines of insurance except health, long-term care, and crop insurance. The Dodd-Frank Act outlines several areas where the FIO has certain powers but also contains language constraining some of the potential FIO activities. The FIO is not an insurance regulator, as the Dodd-Frank Act contains a savings provision stating, "Nothing in this section or section 314 shall be construed to establish or provide the Office or the Department of the Treasury with general supervisory or regulatory authority over the business of insurance."[1]

The FIO does have some important duties. It is charged with monitoring all aspects of the insurance industry and identifying issues or gaps in regulation that could contribute systemic risk. It is authorized to monitor the extent to which underserved communities have access to affordable insurance products. It serves as a non-voting member of the Financial Stability Oversight Council, which has the power to designate a non-bank financial company to be regulated by the Federal Reserve. Once a company is designated, the Federal Reserve Board of Governors must apply "enhanced prudential standards" to such company, including heightened capital requirements and stress tests. The Federal Reserve must coordinate with FIO and any primary federal financial regulator on annual stress tests. The FIO is required to coordinate with the appropriate federal regulatory agencies in issuing regulations regarding stress tests of the systemically important non-bank financial institutions. It is required to assist the secretary of the Treasury in administering the Terrorism Risk Insurance Program.

The FIO is expected to develop federal policy and represent the federal government on "prudential aspects of international insurance matters."[2] As a result, FIO Director Michael T. McRaith will represent the U.S. federal government at meetings of the International Association of Insurance Supervisors (IAIS) and other similar organizations. However, state insurance regulators, either directly or through their NAIC representatives, will continue to present the views of the insurance regulatory community and to actively participate in IAIS activities.

The FIO is tasked with assisting the secretary of the Treasury in negotiating covered agreements:

> A covered agreement is] a written bilateral or multilateral agreement regarding prudential measures with respect to the business of insurance or reinsurance that is entered into between the United States and one or more foreign governments, authorities, or regulatory entities and relates to recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation.[3]

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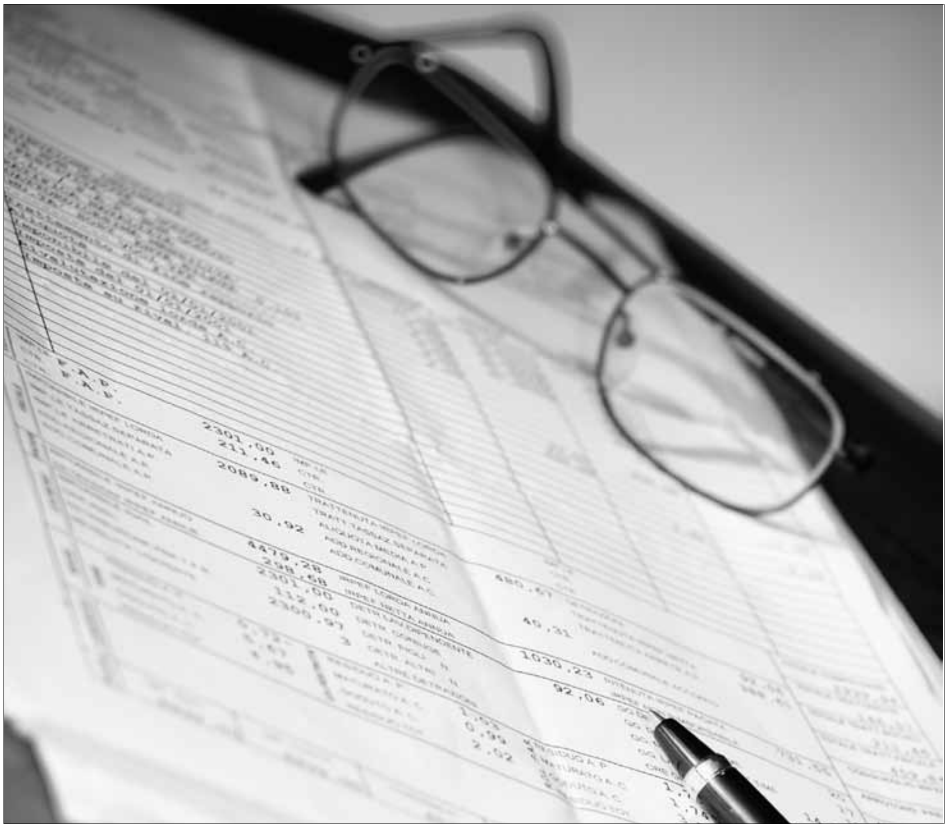
The term substantially equivalent means the prudential measures of a foreign government, authority, or regulatory entity that achieve a similar outcome as those achieved under state law.

The FIO has a role in managing an insolvency of a systemically important non-bank financial institution. It can determine that a systemically risky insurer requires a Dodd-Frank Title II orderly resolution, but there are some strings attached. The determination requires written request of the Treasury secretary, and then there must be a two-thirds vote of the Federal Reserve Board of Governors and an affirmative vote of the FIO director. If these hurdles are overcome, the resolution proceeds; however, the resolution is conducted pursuant to state law. The Federal Deposit Insurance Corp. (FDIC) can step in the shoes of state regulator if no state action is taken within sixty days.

The FIO is also able to consult with the states on insurance matters of national or international importance. It advises the secretary of the Treasury on major domestic and international insurance matters and assists the Treasury in carrying out any related duties or authorities.



Powers

The FIO is authorized to collect data, and it can enter into information-sharing agreements with state regulators and others. Further, the FIO can require an insurer or its affiliate to submit data to the office. However, it must determine whether any public or regulatory sources are available before requiring that such information is sent directly from an insurer. The law provides an exemption for small insurers; however, regulations defining what constitutes a small insurer have not been issued. The FIO does have subpoena power; however, use of the subpoena power is limited. Exercise of the subpoena power requires a written finding that data is required for the office to carry out its functions and that the office has first coordinated with a regulator or agency to ensure there are no other public or regulatory sources for such information.

The FIO is authorized to assist the Treasury secretary and U.S. trade representative in negotiating covered agreements, as described earlier. Such agreement must provide consumer protections substantially equivalent to those under state law. To be substantially equivalent, the outcome of the agreement must provide at least the same level of consumer protections as those contained in state laws and regulations. Further, before a covered agreement can be executed, the secretary of the Treasury and U.S. trade representative must consult with the House Financial Services Committee, the House Ways and Means Committee, the Senate Finance Committee, and the Senate Banking Committee. The consultation occurs when the Secretary of the Treasury and U.S. trade representative jointly submit the proposed covered agreement to the committees listed above. There is a layover period of 90 days specified in the law.[4]

The FIO has some limited preemption powers regarding conflicting state laws and regulations. The FIO can recommend preemption of a state law or regulation if 1) applying the state law or regulation results in less-favorable treatment of a non-U.S. insurer subject to the covered agreement than a U.S. insurer admitted in the state and 2) the law or regulation is inconsistent with the terms of the covered agreement.[5] There is also a savings provision prohibiting the preemption of any state law or regulation governing an insurer's rates, premiums, underwriting practices, sales practices, or insurance coverage requirements.[6] Further, there can also be no preemption of state antitrust laws or regulations that apply to the business of insurance.[7] State measures governing solvency or capital requirements are free from preemption unless the state insurance measure results in less-favorable treatment of a non-U.S. insurer than a U.S. insurer.[8]

There are procedural steps the FIO is required to follow if preemption is to occur. The process starts with a notice called the Notice of Potential Inconsistency. The first steps require the FIO director to provide notice to a state regarding the inconsistency, consult with the Office of the U.S. Trade Representative, and publish notice of the inconsistency in the Federal Register for comment.[9] Following an investigation to consider written comments received in response to the publication in the Federal Register, the FIO director will issue a Notice of Determination of Inconsistency and advise the affected state of the determination and the extent of the inconsistency. The notice shall establish the effective date of the preemption, which must be reasonable and cannot be less than 30 days after the notice.[10] The FIO director must also notify the House Financial Services Committee, the House Ways and Means Committee, the Senate Finance Committee, and the Senate Banking Committee. The third and final step occurs if the inconsistency is not addressed by the state during the time period specified in the Notice of Determination of Inconsistency. Then the FIO director will issue a Notice of Effectiveness specifying that the preemption has become effective and providing an effective date. After the effective date, the state may not enforce the preempted law or regulation. The Notice of Effectiveness must be published in the Federal Register, and the FIO must also communicate directly with the affected state.[11]

If a state wishes to contest the determination that its law or regulation is inconsistent, and therefore preempted, it may do so, and the Federal Administrative Procedures Act will apply. However, there is a requirement that any judicial review of the determination is *de novo*,[12] a Latin phrase meaning "from the beginning." As applied in this circumstance, it would mean the trial judge would hear the evidence that both sides wished to present and would not give the FIO's decision any legal deference.

Reports

One of the main functions of the FIO is to issue reports. At the time of this writing, the initial, long-awaited report on "how to modernize and improve the system of insurance regulation in the United States"[13] has not been released. The deadline for the report was eighteen months following enactment of the Dodd-Frank Act. In real time, the deadline was January 23, 2012.

The FIO is responsible for issuing certain annual reports to Congress. Beginning September 30, 2011, and by September 30 each subsequent year, the FIO was required to issue an annual report documenting any preemption actions.[14] This report is intended to inform Congress about the insurance industry and to provide information deemed important by the FIO director or requested by the House Financial Services Committee, the House Ways and Means Committee, the Senate Finance Committee, and the Senate Committee on Banking, Housing and Urban Affairs.[15] So far the FIO has not undertaken any preemption actions—and the report has not yet been issued.

The FIO has responsibility for other one-time reports. On September 30, 2012, it is to deliver a report "describing the breadth

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Mission Statement

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Vision

The Regulatory and Legislative Interest Group strives:

- To be the first place Society members choose to learn about proposed or recently enacted insurance laws and regulations.
- To be recognized within the Society as one of the premier interest groups.
- To provide relevant regulatory information about all countries, including those that may impact United States marketplaces.
- To be a trusted source of information about the various United States insurance markets.
- To provide a forum for discussion on pertinent regulatory or legislative issues.

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and scope of the global reinsurance market and the critical role such market plays in supporting insurance in the United States."[16] A report is due on or before January 1, 2013, describing the impact of the changes to reinsurance regulation on regulators' access to reinsurance information for regulated companies in their jurisdiction. This report is intended to measure the impact of changes to reinsurance regulation, where the domestic regulator of a reinsurer is now the sole regulator for solvency, provided that the state is accredited by the NAIC or has substantially similar financial solvency requirements as accredited states. An update to this report is required on or before January 1, 2015.[17] The FIO may also decide to produce other unspecified reports.

Conclusion

The Federal Insurance Office is open for business. It is charged with advising the secretary of the Treasury and providing Congress with reports regarding the fifty-six independent U.S. insurance jurisdictions that form the national, state-based insurance regulatory system. These state-based insurance markets comprise roughly one-third of the world insurance markets, ranging from the sixth largest market in the world, California, to the 104th largest jurisdiction in the world, Wyoming.[18]

Insurance regulators look forward to working closely with the newly formed FIO to more fully represent the interests of U.S. insurers and insurance regulators in the international insurance community.

Once the FIO releases its long-awaited study, a follow-up article will appear in this newsletter. ■

Endnotes

(1) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(k).

(2) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(c)(1)(E).

(3) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(r)(2).

(4) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 314.

(5) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(f).

(6) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(j)(1)(A)&(B).

(7) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(j)(1)(C).

(8) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(j)(1)(D).

(9) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(f)(2)(A).

(10) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(f)(2)(C).

(11) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(f)(3).

(12) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(g).

(13) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(p).

(14) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(n)(1).

(15) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(n)(2).

(16) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(o)(1).

(17) The Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 313(o)(2).

(18) U.S.-written premiums are provided by the NAIC, and the international premiums were obtained from Swiss Reinsurance at http://media.swissre.com/documents/WI_2010_Appendix_update_v2.pdf. Guam, the U.S. Virgin Islands, the Northern Marianas Islands, and American Samoa do not make the Top 100 insurance jurisdictions list.